

Decision **PROPOSED DECISION OF ALJ GALVIN** (Mailed 12/13/2005)

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

Application of Southern California Edison Company (U 338-E) for a Commission Finding that its Procurement-Related and Other Operations for the Recorded Period January 1 Through December 31, 2004 Complied with its Adopted Procurement Plan; for Verification of its Entries in the Energy Resource Recovery Account and other Regulatory Accounts; for Recovery of a Nuclear Unit Incentive Reward of \$12.6 million; and for Recovery of \$6.7 Million Recorded in the Electric Energy Transaction Administration Memorandum Account.

Application 05-04-004  
(Filed April 1, 2005)

Robert Keeler, Attorney at Law, for Southern California Edison Company, applicant.

Regina DeAngelis, Attorney at Law, for the Office of Ratepayer Advocates.

**OPINION ON THE REASONABLENESS AND PRUDENCE  
OF SOUTHERN CALIFORNIA EDISON COMPANY'S  
ENERGY RESOURCE RECOVERY ACCOUNT &  
OTHER BALANCING ACCOUNTS**

**I. Summary**

We find Southern California Edison Company's (SCE) administration of power purchase agreements and its least-cost dispatch activities for the period beginning January 1, 2004 and ending December 31, 2004 (Record Period) reasonable and prudent. We also find its \$171.9 million undercollected Energy

Resource Recovery Account (ERRA), \$12.6 million Palo Verde Nuclear Unit Incentive Procedure (NUIP) reward amount, \$6.4 million undercollected Electrical Energy Transaction Administration Memorandum Account (EETAMA), and other regulatory account balances at December 31, 2004 identified in the body of this order reasonable and recoverable.

## **II. Background**

Decision (D.) 02-10-062 established an ERRA balancing account for the major energy utilities to track fuel and purchased power revenues against actual recorded costs. That decision required the major energy utilities to establish an annual ERRA fuel and purchased power revenue requirement forecast and an annual ERRA reasonableness review through the application process.

An October 1<sup>st</sup> date was set for SCE's annual ERRA forecast application. However, that date was subsequently changed to August 1<sup>st</sup> pursuant to D.04-01-050. An April 1<sup>st</sup> date was set for SCE's annual ERRA reasonableness application. The purpose of that latter application, now before us, is to review the reasonableness of SCE's energy resource contract administration, least-cost dispatch, ERRA, and other non-ERRA balancing account mechanisms.

## **III. Contract Administration**

SCE's contract administration process consists of several activities, including exercising contract options in a prudent manner; verifying that the other party is complying with the contract terms, including credit support and collateral requirements; verifying that billing and payments are accurate and consistent with the terms of the contract; reviewing interruptions of service and force majeure events; renegotiating contract provisions due to changed circumstances or conditions; resolving disputes; purchasing natural gas fuel

under certain types of contracts; and assigning, renewing or terminating contracts.

The Division of Ratepayer Advocates (DRA), formerly the Office of Ratepayer Advocates, conducted an independent review and analysis of SCE's application, testimony, workpapers, data responses, and written description of SCE's contract administration procedures, including confidential information placed under seal. DRA concluded from its review and analysis that SCE prudently and diligently administered its qualified facilities (QF), non-QF, and Department of Water Resources (DWR) allocated contracts. Based on this independent analysis and conclusion, we find that SCE's administration of its power purchase contracts during the Record Period was reasonable and prudent.

#### **IV. Least-Cost Dispatch**

In D.02-12-074, the Commission required energy utilities to include Standard of Conduct No. 4 (SOC 4) as part of their procurement plans. Under SOC 4, energy utilities are required to prudently administer all contracts within the terms and conditions of those contracts and to dispatch contracts when it is most economical to do so. SOC 4 also requires the utilities to dispose of economic long power and to purchase economic short power based on a least-cost dispatch process. Least-cost dispatch refers to a situation in which the most cost-effective mix of total resources is used, thereby minimizing the cost of delivering electric services.<sup>1</sup>

SCE implements this least-cost standard by evaluating all dispatchable resources available to it based on daily market conditions at the time of dispatch

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<sup>1</sup> D.02-12-074, Ordering Paragraph 24b, mimeo., p. 74.

into the daily, hourly and real-time markets. SCE decides which resources under its control would be most economical to dispatch by comparing the variable operating cost of each dispatchable unit with the market price of power at the time of dispatch. If the variable operating cost of a given dispatchable unit is less than the market price of power, the unit is dispatched. If the variable operating cost is greater than the market price, the unit is not dispatched.

DRA's independent examination of SCE's least-cost dispatch consisted of a review of the application and prior Commission decisions guiding the least-cost dispatch process, meetings with SCE staff, review and follow up of data responses, review of SCE internal Risk Management Committee meeting minutes, and detailed hourly data from three sample days.

DRA found from its independent examination that the deviations in SCE's load and resource forecasts were reasonable and that the day-ahead spot transactions were in line with the published day-ahead market prices.<sup>2</sup> DRA also found from its analysis that hour-ahead sales prices were significantly lower than hour-ahead purchase prices during on-peak and off-peak periods. Because SCE did not substantiate the reasonableness of these price differences to DRA, it concluded that SCE failed to comply with the least-cost standard that it act in the most cost-effective manner and that a monetary penalty was appropriate.

DRA recommends a \$16.36 million disallowance (\$7.91 million for on-peak hour-ahead sales and \$8.45 million for off-peak hour-ahead sales) for SCE selling

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<sup>2</sup> Exhibit 8, p. 4 and p. 7 through p. 8.

energy in the hour-ahead market at unreasonable prices compared to the prices SCE pays for purchases in the hour-ahead market.<sup>3</sup>

As required by Ordering Paragraph 24b of D.02-12-074, the utilities have the burden of proving compliance with the least-cost standard. However, that decision was silent on how the utilities should substantiate that they acted in the most cost-effective manner. Not recommending a specific standard for SCE to use in this instance, DRA applied the differences between average sales and purchases on a monthly basis to assess whether SCE satisfied the least-cost standard.<sup>4</sup>

However, the reasonableness review undertaken by DRA is not an appropriate method. This is because such a comparison inappropriately assumes that hour-ahead sales and purchases are comparable. These transactions are not comparable because they are impacted by demand, availability of product types, delivery points, volatility of minute-to-minute changes in natural gas prices, transmission conditions, and load or resource forecasts.

There is no dispute that SCE is required to substantiate that its hour-ahead sales and purchases were made in the most cost-effective manner.

Unfortunately, there is no hour-ahead sale or purchase market to compare the reasonableness of SCE's activities. It is not reasonable to hold SCE to a "most cost-effective" standard when neither D.02-12-074 nor DRA recommends a

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<sup>3</sup> The disallowance was based on the average price between the monthly hour-ahead purchase and sale prices as the price SCE should have received for its sales. DRA calculated its disallowance by multiplying the monthly hour-ahead sales of SCE by the difference between the average price and the actual price SCE received for its monthly hour-ahead sales.

<sup>4</sup> Reporter's Transcript, Vol. 1, p. 60, line 22 through p. 61, line 18.

specific method or procedure to satisfy this standard. Absent an established “most cost-effective” standard, we review the process SCE currently uses to assess the reasonableness of its least-cost dispatch process.

Under its process, SCE rank-orders all available dispatchable resources, with the resource having the lowest variable operating cost being ranked first. The lowest cost resource is dispatched first; the second lowest cost resource is dispatched second, and so on up the supply stack.

If SCE is short on dispatchable resources to meet its load, it dispatches only those resources within its portfolio whose variable operating costs are below the market price of power. Resources whose variable operating costs are above the market price of power are not dispatched. SCE balances its short positions by purchasing additional energy in the daily and hourly spot market until its load is satisfied. If SCE has more dispatchable resources in its portfolio than it needs to meet its load, it dispatches all resources whose variable operating costs are less than the market price of power. Any excess energy is then sold in the daily and hourly spot market to maximize its value.

SCE also established protocols designed to assure that its dispatch decisions result in use of the most cost-effective mix of total resources to minimize the cost of delivering electric services and to satisfy the SOC 4 least-cost dispatch efficiency requirement. Details of these protocols are set forth in Exhibits 1 and 7. SCE’s least-cost dispatch process is reasonable.

Given the reasonableness of SCE’s least-cost dispatch process and absence of a standard to assess the “most cost-effectiveness” of its hour-ahead market transactions, we must reject the disallowance recommended by DRA. SCE and DRA should work jointly in establishing a standard to satisfy the most cost-effective standard of SCE’s hour-ahead activities. Until such a standard is

established, SCE should continue to maintain a record of its actual hour-ahead sales prices with bid prices in the same time period from other entities that purchase energy from SCE. SCE should also maintain a record of its actual hour-ahead purchase prices with asking prices from other entities selling energy, to the extent publicly available.

#### **V. Energy Resource Recovery Account (ERRA)**

Consistent with D.03-07-029, SCE used its ERRA to record the difference between ERRA-related revenue and its utility retained generation fuel costs and purchased power-related expenses during the Record Period. DWR power contract expenses were excluded from the ERRA. Details of its ERRA activity for the Record Period resulting in a \$171.9 million undercollected balance at December 31, 2004 are set forth in Table XIII-18 to its prepared testimony.

ORA scrutinized the testimony, exhibits, and workpapers of SCE which included documents supporting revenue and expense entries into the ERRA during the Record Period. ORA concluded from its scrutiny that the ERRA balance was appropriate, supported, correctly stated, and in compliance with Commission decisions. Based on this independent analysis and conclusion of SCE's ERRA activity during the Record Period, we find that the \$171.9 million undercollected ERRA balance at December 31, 2004 is reasonable and recoverable.

#### **VI. Palo Verde Nuclear Unit Incentive Procedure (NUIP)**

The NUIP provides incentive rewards for those nuclear units that perform above an 80% capacity factor. If a reward is achieved, SCE's customers and shareholders share equally in the difference between the additional cost per kilowatt-hour (kWh) of nuclear fuel and the replacement power cost of the

output above that capacity factor. In D.01-09-041, the Commission capped the replacement power cost at five cents/kWh and extended the ratemaking mechanism for Palo Verde Units 1, 2, and 3 until the effective date of SCE's next general rate case (GRC) or further order of the Commission.

In D.04-07-022, the Commission implemented SCE's 2003 GRC revenue requirement effective May 22, 2003. Hence, the NUIP rewards requested in this proceeding were calculated and prorated through May 21, 2003 as summarized in Table XIV-30 and detailed in Tables XIV-31 through Table XIV-33 of Exhibit 2. SCE calculated its NUIP based on the five-cent ceiling rate because its replacement power cost exceeded this ceiling rate.

DRA scrutinized SCE's NUIP reward calculation and concluded that the reward was properly calculated. Based on this independent analysis and conclusion, we find the \$12.6 million NUIP reward applicable to SCE's Palo Verde Unit 3 reasonable and recoverable.

## **VII. Electric Energy Transaction Administration (EETA)**

EETA administrative and general costs are those costs incurred by SCE to procure, dispatch, settle, and administer procurement-related transactions. At December 31, 2004, SCE had a \$6.4 million undercollected balance in its EETA Memorandum Account (EETAMA). Details of its activity in this mechanism for the period January 1, 2003 through December 31, 2004 were set forth in Table XVI-50 of Exhibit 2, as revised in Exhibit 6.

SCE requested that the costs recorded in its EETAMA from January 1, 2003 through December 31, 2004 be found reasonable and transferred to its Base Revenue Requirement Balancing Account (BRRBA). The BRRBA compares, on a monthly basis, the Commission-authorized distribution and generation base-



related revenue requirements, including authorized EETA costs, with applicable retail revenues from distribution and generation base-related rates and includes distribution and generation sub-accounts to track over- and undercollections. The actual rate level change associated with the recovery of EETA costs through the BRRBA is to take place in a subsequent ERRA forecast proceeding, where SCE presents its consolidated revenue requirements and rate changes.

DRA scrutinized SCE's EETA costs and concluded that the balance was properly calculated. Based on this independent analysis and conclusion, we find the December 31, 2004 EETAMA balance of \$6.4 million is reasonable and recoverable.

#### **VIII. Non-ERRA Balancing and Memorandum Accounts**

SCE provided testimony on the activities of several non-ERRA balancing account mechanisms during the record period. These mechanisms consisted of SCE's Electric Distribution Revenue Adjustment Balancing Account (EDRABA), BRRBA, Other Distribution Adjustment Mechanism (ODAM), Nuclear Decommissioning Adjustment Mechanism (NDAM), Public Purpose Programs Adjustment Mechanism (PPPAM), and California Alternative Rates for Energy (CARE) Balancing Account (CBA). It also included the activities of its EDRABA, ODA, NDAM, PPPAM, and CBA accounts for the period July 1, 2003 through December 31, 2003 pursuant to D.05-02-006.

The following tabulation sets forth a summary of the individual balances and net balance of the balancing account mechanisms at the end of the Record Period. Details of the activities of these balancing account mechanisms are set forth in Exhibit 2.

<b>Mechanism</b>	<b>Millions Undercollected (Overcollected)</b>
EDRABA <sup>5</sup>	\$ 0.0
BRRBA	(7.0)
ODAM	(4.0)
NDAM	1.6
PPPAM	23.8
CBA	2.5
ERRA	3.2
Net Balance Undercollected	\$20.1

SCE also provided testimony on the activities of its Energy Settlement Memorandum Account (ESMA) and Litigation Cost Tracking Account (LCTA) during the Record Period as authorized by Commission Resolution E-3894. Details of the activities of these memorandum accounts were set forth in Exhibit 2. The ESMA had a \$103.9 million balance at December 31, 2004, and the LCTA had a \$3.9 million balance.

SCE seeks a Commission finding that the entries recorded in these ratemaking mechanisms and memorandum accounts and their respective balances at December 31, 2004 are appropriate and correctly stated.

DRA scrutinized the entries recorded in the above identified non-ERRA balancing and memorancum accounts and did not find any instances of

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<sup>5</sup> The \$151.0 million overcollected balance in this account at June 30, 2004 was transferred to the BRRBA pursuant to D.04-07-022. The EDRABA no longer exists.

unreasonableness.<sup>6</sup> Based on this independent analysis and conclusion, we find the December 31, 2004 balances of these non-ERRA balancing and memorandum accounts reasonable and recoverable.

### **IX. Revenue Requirement Impact**

SCE does not propose any rate changes in this proceeding. Instead, SCE seeks authority to transfer the NUIP and EETA approved balances to its appropriate balancing accounts for consolidation in its rate change to be adopted in the January 1, 2006 ERRR forecast proceeding. The NUIP reward and EETA amount will impact 2006 total revenues by 0.2%.

SCE also seeks to include the non-ERRR balancing accounts approved in this proceeding as part of a consolidated rate change with other approved rate changes for implementation effective January 1, 2006.

There is no objection to SCE's revenue requirement proposal. We concur, as its proposal minimizes the number of rate changes within a relatively short period of time.

### **X. Confidential Information**

SCE tendered testimony as part of its reasonableness application to substantiate the prudence of its contract administration, least-cost dispatch, and ERRR for the Record Period. Portions of SCE's data and testimony deemed commercially sensitive were tendered under seal, pursuant to General Order 66-C. Due to the commercially sensitive, confidential, and proprietary information on SCE's electric energy resources and its management of power resources to meet customers needs on a least-cost basis, all such information

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<sup>6</sup> Reporter's Transcript Vol. 1, p. 56, lines 4 through 11.

deemed commercially sensitive was placed under seal pursuant to a May 5, 2004 Administrative Law Judge (ALJ) ruling.

This information and subsequent associated information placed under seal relates to certain purchased power contract terms and costs, individual power prices, net position cost assumptions and other information that might put SCE at a competitive disadvantage, if revealed. Maintaining this information under seal is reasonable and consistent with the provisions of Pub. Util. Code § 454.5(g), which states the Commission shall adopt appropriate procedures to ensure the confidentiality of any market sensitive information submitted in an electrical corporation's proposed procurement plan. All such information placed under seal in this proceeding should remain sealed until the Commission issues a decision in Rulemaking 05-06-040 that establishes a consistent treatment of confidential procurement information for the major energy utilities. Upon the issuance of such a decision in the rulemaking proceeding, the sealed information shall conform to the requirements of that decision.

## **XI. Procedural Matters**

SCE requested that this matter be categorized as ratesetting. By Resolution ALJ 176-3151, dated April 21, 2005, the Commission preliminarily determined that this was a ratesetting proceeding and that hearings may be necessary. The Assigned Commissioner confirmed these preliminary determinations in a scoping memo and ruling issued May 24, 2005.

Notice of the application appeared in the Commission's Daily Calendar of April 8, 2005. An evidentiary hearing was held on September 27, 2005 and this matter was submitted upon the receipt of reply briefs on October 31, 2005.

**XII. Comment on Proposed Decision**

The proposed decision of the ALJ in this matter was mailed to the parties in accordance with Pub. Util. Code § 311(d) and Rule 77.1 of the Rules of Practice and Procedure. Comments were filed by SCE and reply comments by DRA.

**XIII. Assignment of Proceeding**

Michael R. Peevey is the Assigned Commissioner and Michael J. Galvin is the assigned ALJ in this proceeding.

**Findings of Fact**

1. The application was filed on April 1, 2005, and appeared in the Commission's Daily Calendar on April 8, 2005.
2. SCE provided detailed exhibits and testimony on its administration of power purchase agreements, least-cost dispatch activities, and procurement-related revenue and expenses recorded in its ERRA for the Record Period.
3. DRA provided testimony on the results of its independent examination of SCE's administration of power purchase agreements, least-cost dispatch activities, ERRA, and other balancing accounts.
4. DRA scrutinized the source of entries recorded in SCE's ERRA through its review of contract administration and least-cost dispatch activities during the Record Period.
5. Exhibits 1 through 6 and Sealed Exhibits A through D provided detailed support for transactions recorded in SCE's ERRA during the Record Period.
6. Hour-ahead sales and purchases are impacted by demand, availability of product types, delivery points, volatility of minute-to-minute changes in natural gas prices, transmission conditions, and load or resource forecasts.
7. There is no hour-ahead sale or purchase market.

8. There is no established method to determine whether the hour-ahead sales and purchases of SCE were made in the most cost-effective manner.

9. NUIP provides incentive rewards for those nuclear units that perform above an 80% capacity factor.

10. DRA took no exception to SCE's NUIP reward calculation.

11. DRA took no exception to the costs recorded in SCE's EETAMA.

12. DRA took no exception to the December 31, 2004 balances in SCE's non-ERRA balancing and memorandum accounts identified in the body of this order.

13. Information that would place SCE in a competitive disadvantage if disclosed was placed under seal.

### **Conclusions of Law**

1. SCE's administration of its ERRA contracts during the Record Period was reasonable and prudent.

2. Least-cost dispatch activities during the Record Period were prudently performed and complied with SOC 4 in SCE's approved procurement plan.

3. SCE's \$171.9 million undercollected ERRA balance at December 31, 2004 is reasonable and recoverable.

4. SCE's \$12.6 million May 22, 2003 NUIP reward applicable to its Palo Verde Unit 3 is reasonable and recoverable.

5. SCE's \$6.7 million December 31, 2004 EETAMA balance is reasonable and recoverable.

6. The December 31, 2004 LCTA balance of \$3.9 million and ESMA balance of \$103.9 million were reasonable.

7. December 31, 2004 non-ERRA balancing account amounts identified in the body of this order are reasonable and recoverable.

8. SCE's revenue requirement proposal is reasonable and should be adopted.
9. Information placed under seal should remain sealed.
10. This decision should be effective today, in order to allow the docket to be closed expeditiously.

**O R D E R**

**IT IS ORDERED** that:

1. Southern California Edison Company's (SCE) administration of its power purchase agreements and its least-cost dispatch activities for the period beginning January 1, 2004 and ending December 31, 2004 was reasonable and prudent.

2. SCE's \$171.9 million undercollected Energy Resource Recovery Account (ERRA) balance at December 31, 2004 and its procurement-related revenue and expenses recorded in its ERRA in that Record Period were reasonable and prudent.

3. SCE and the Division of Ratepayer Advocates shall work jointly in establishing a standard to satisfy the "most cost-effective" standard of SCE's hour-ahead activities.

4. A Nuclear Unit Incentive Procedure (NUIP) reward of \$12.6 million applicable to SCE's Palo Verde was reasonable and is recoverable.

5. Electric Energy Transaction Administration (EETA) costs recorded in SCE's EETA memorandum account during the January 1, 2003 through December 31, 2004 period, resulting in a \$6.4 million undercollected balance, reasonable and recoverable.

6. SCE is authorized to transfer its NUIP and EETA approved balances to the appropriate balancing accounts for consolidation in its rate change to be adopted in the January 1, 2006 ERRRA forecast proceeding.

7. All information placed under seal shall remain sealed until the Commission issues a decision in Rulemaking 05-06-040 that establishes a consistent treatment of confidential procurement information for the major energy utilities. Upon the issuance of such a decision in the rulemaking proceeding, the sealed information in this proceeding shall be treated in conformance to the requirements of that decision.

8. Application 05-04-004 is closed.

This order is effective today.

Dated \_\_\_\_\_, at San Francisco, California.